

Internal Revenue Service
memorandum

CC:TL-N-464-90

Brl:HFRogers

date: NOV 6 1989

to: District Counsel, Louisville CC:LOU

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Rev. Proc. 81-27's applicability in cases in which
a decision is entered pursuant to I.R.C. § 7481(d)

This is in response to your request for tax litigation
advice dated October 11, 1989.

ISSUE

Whether the procedures outlined in Rev. Proc. 81-27, 1981-2
C.B. 548, can continue to be used in cases where a decision has
been entered in the Tax Court pursuant to I.R.C. § 7481(d).
7481-0000.

CONCLUSION

Rev. Proc. 81-27, 1981-2 C.B. 548, is not available to an
estate once a petition has been filed in the Tax Court. Once a
petition has been filed in the Tax Court, the principles of
finality of judgment and res judicata preclude use of this
procedure to reduce a final judgment of tax liability as
determined by the court. Section 7481(d) provides only a limited
exception to the principle of finality of judgments.

FACTS

While preparing a decision document for a settled case, the
question arose whether the provisions of Rev. Proc. 81-27, 1981-
2 C.B. 548, could continue to be used by the estate. The estate
had elected to make extended payments pursuant to the provisions
of section 6166.

DISCUSSION

Section 2053(a)(2) provides that administration expenses
allowable under local law are deductible in determining the value
of the gross estate. Treas. Reg. § 20.2053-3(a) provides that
the amounts deductible from a decedent's gross estate as
administration expenses are limited to such expenses as are

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actually and necessarily incurred in the administration of the decedent's estate. While estimated items may be entered on the estate tax return, no deduction may be taken upon the basis of a vague or an uncertain estimate. Treas. Reg. § 20.2053-1(b)(3).

For many years, the Service took the position that interest on an estate tax deficiency or any unpaid estate tax liability was not a deductible administration expense. However, in Rev. Rul. 78-125, 1978-1 C.B. 292, the Service announced that it would follow the Tax Court's opinion in Estate of Bahr v. Commissioner, 68 T.C. 74 (1977), acq. 1978-1 C.B. 1, wherein the court held that the interest expense incurred by the taxpayer on the unpaid balance of its federal estate tax liability deferred under section 6161 was deductible as an administration expense under section 2053(a)(2). See also Rev. Rul. 79-252, 1979-2 C.B. 333.

Relying on Bahr, petitioners began deducting interest on their estate tax returns which had not yet accrued but which the estate estimated it would pay during the pendency of the installment period. In Estate of Bailly v. Commissioner, 81 T.C. 246 (1983) [hereinafter referred to as Bailly I], the Service was successful in arguing that no deduction was allowable for an estimated interest deduction because the expense cannot be estimated with reasonable certainty as required by Treas. Reg. § 20.2053-1(b)(3). Rev. Rul. 80-250, 1980-2 C.B. 278, pointed out that the possibility of accelerated payment rendered any estimate vague and uncertain. Another factor rendering the estimate vague and uncertain was the fluctuation in interest rates. Interest rates under sections 6621 and 6601(j) are subject to change. Therefore, because installment payments may be accelerated at the option of the estate or at the option of the Service if there is a default or disposition, and because rates may fluctuate, there is a very real possibility that future interest will neither accrue nor be paid. Accordingly, the court agreed with the Service that the estate is not entitled to an estate tax deduction on its estate tax return.¹ However, Bailly I contained some troubling language that was subsequently clarified in Bailly II which followed as a result of petitioner's motion for reconsideration. 81 T.C. 949. In Bailly I, the court implied that, although the estate was unable to take interest deductions up front, the estate would be able to utilize the procedures set out in Rev. Proc. 81-27 in order to claim the interest deduction after the interest had been paid.

Rev. Proc. 81-27 describes the procedure to be followed by an estate when installment payments due under section 6166 are recomputed because of a reduction in the total estate tax

¹ The interest expense may, of course, be deducted from the estate's gross income on Form 1041 pursuant to section 163, subject to the restrictions of section 642(g).

liability due to the accrual of interest. Citing Rev. Rul. 80-250, Rev. Proc. 81-27 provides that because interest is deductible only when accrued, the estate tax may be recomputed after additional interest has been incurred. The procedure involves the filing of a supplemental Form 706 as each incremental installment of interest is paid.

We disagreed with the Tax Court's view in Bailly I that the Bailly estate would be able to utilize this procedure. In the Tax Court context, the principle of finality of judgments, as expressed in the doctrine of res judicata, would preclude the use of this procedure to alter a final judgment entered by the Tax Court. Tait v. Western Maryland Railway Co., 289 U.S. 620 (1935); Commissioner v. Sunnen, 333 U.S. 591 (1948). As the legislative history of section 6215 indicates, Congress intended that no change was to be made in the amount of the deficiency determined by the Tax Court after the decision of the court becomes final, "no matter how meritorious a claim for abatement of the assessment or for refund" may be raised thereafter. "Finality is the end sought to be attained by these provisions ... and to allow the reopening of the question of the tax ... either by the taxpayer or by the Commissioner (save in the sole case of fraud) would be highly undesirable." S. Rep. No. 52, 69th Cong., 1st Sess. 26 (1926), reprinted in 1939-1 (Part 2) C.B. 332, 351. In Bailly II, the court noted that it was "unlikely" that petitioner could utilize the procedure set out in Rev. Proc. 81-27 because section 6512(a) would probably be construed as barring any claim for refund after a petition has been filed in the Tax Court.²

Accordingly, in the spirit of cooperation and attempting not to appear unduly harsh, the Service did not object to the petitioner's request that the court defer entry of decision. The court agreed to postpone entry of decision under Rule 155 until the final installment of the estate tax liability was due or paid whichever was earlier.

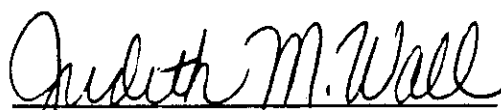
The enactment of section 7481(d) allows the Tax Court to enter decisions in cases where the estate elects section 6166 installment payments and allows the decisions to be reopened at a later date for the limited purpose of allowing the estate to take a section 2053 deduction for the interest the estate has paid on deferred federal and state death taxes. The enactment of section 7481(d) did not alter our position regarding the availability of Rev. Proc. 81-27. That procedure was not available prior to the enactment of section 7481(d). See Bailly II, at 954. The

² Section 6512(a) provides that no credit or refund may be claimed and no suit shall be instituted in any court, if a taxpayer files a timely petition with the Tax Court after receiving a notice of deficiency.

principles of res judicata and finality of judgment encouraged us to develop a statutory alternative to Rev. Proc. 81-27. That alternative was initially deferring entry of decision as in Bailly and then the enactment of section 7481(d). Once a petition is filed with the Tax Court, the estate is no longer entitled to use Rev. Proc. 81-27 because that procedure is in the nature of a claim for refund which is prohibited by section 6512(a).

If you have any further questions, please contact Helen F. Rogers at FTS 566-3442.

MARLENE GROSS

By: 
JUDITH M. WALL
Chief, Branch 1
Tax Litigation Division

cc: Returns Processing and Accounting Division I-TR:R